In the Supreme Court of the United States

OCTOBER TERM, 1941

NO. .....

MAY RYAN, Executrix of the Will and Estate
of Thomas Ryan, Deceased,
Petitioner,

VERSUS

ACEL C. ALEXANDER, Formerly Collector
of Internal Revenue,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF IN SUPPORT OF PETITION

I.

DECISIONS IN COURTS BELOW

This case originated in the District Court of the United States for the Western District of Oklahoma. It is a law action triable by a jury, but trial by jury was waived in writing and a trial had to the court. The findings and decision of the trial court is not officially reported, but appears at pages 48 to 55 of the record.

The opinion of the Circuit Court of Appeals is reported in 118 Fed. (2d) 744.

II.
STATEMENT OF THE CASE

A statement of the case containing all that is material to the consideration of the questions presented with appropriate page references to the printed record has been made in the petition for the writ and such statement is hereby adopted and made a part of this brief.

III.
ASSIGNMENT OF ERRORS

The petitioner makes the following assignment of errors committed in the opinion and decision of the court below:

1. The Circuit Court of Appeals erred in holding that the taxpayer was estopped to claim a refund of tax overpaid for 1924 as the result of the erroneous inclusion in income on his return for that year of certain items of income which belonged in the year 1925 on the ground that the assessment of additional tax upon such items for 1925 was barred by limitation when he filed his claim for refund.

2. The Circuit Court of Appeals erred in holding that the taxpayer was not entitled to have an allowance for depletion on the oil production and bonuses for leases received from his land in 1924 computed on the discovery value thereof resulting from the Hully Sands offset well, part of the cost of which he paid for the purpose of discovering oil on his land and by which he did discover oil on it.

3. The Circuit Court of Appeals erred in not holding that the assessment and collection in 1929 of a deficiency in the taxpayer's tax for 1924 was illegal and void in its entirety, because made while his appeal from the determination of such deficiency was pending and undetermined before the Board of Tax Appeals and hence in direct contravention of the express prohibition of the statute.

4. The Circuit Court of Appeals erred in that, after holding that the taxpayer by depositing $36,500 with the collector to be held in a special fund without assessment waived the restriction on the assessment of that sum while his appeal was pending before the Board of Tax Appeals, it did not hold that the assessment at the same time of the additional sum of $9,135.73 and the collection thereof by distraint was an illegal and void assessment and collection

5. The Circuit Court of Appeals erred in that, after holding that the taxpayer's appeal to the Board of Tax Appeals was a nullity because not timely filed, it did not hold that the assessment and collection of the deficiency in tax in November, 1929, was illegal and void because barred by limitation when made.

IV.
ARGUMENT

Synopsis of Argument

In support of the errors assigned the petitioner asserts and relies on the following propositions which will be presented and considered in order:

1. The taxpayer was not estopped to claim a refund of tax overpaid for 1924 as the result of the erroneous inclusion in income on his return for that year of certain items of income which belonged in the year 1925 on the ground that the assessment of additional tax upon such items for 1925 was barred by limitation when he filed his claim for refund.

2. The taxpayer was entitled to have his allowance for depletion on the oil production and bonuses for leases received from his land in 1924 computed on the discovery value thereof resulting from the Hully Sands offset well, part of the cost of which he paid for the purpose of discovering oil on his land and by which he did discover oil on it.

3. The assessment and collection in 1925 of a deficiency in the taxpayer's tax for 1924 was illegal and void in its entirety because made while his appeal from the determination of such deficiency was pending before the Board of Tax Appeals, or, if his appeal to the Board was void, then because made after the assessment and collection of such deficiency was barred by limitation.

4. If by depositing $36,500 with the collector to be held in a special fund without assessment the taxpayer waived the statutory restrictions on assessment of that sum while his appeal was pending before the Board of Tax Appeals, still the assessment of the additional sum of $9,135.73 and the collection thereof by distraint was an illegal and void assessment and collection, because made while his appeal was pending before the Board, or, in

event that appeal was a nullity, then because made after the assessment and collection thereof was barred by limitation.

Proposition One.

The taxpayer was not estopped to claim a refund of tax overpaid for 1924 as the result of the erroneous inclusion in income on his return for that year of certain items of income which belonged in the year 1925 on the ground that the assessment of additional tax upon such items for 1925 was barred by limitation when he filed his claim for refund.

It is a fundamental principle of income taxation that the tax is imposed and collected with reference to a fixed period of time. A taxpayer may keep his books of account and make his income tax return on either a cash receipts and disbursements basis or an accrual basis. But there is no better settled rule in respect of income taxation than that, according to whatever method of accounting the taxpayer uses, items of income must be included on the return for the year in which they belong and items of deduction must be taken, if taken at all, in the year in which they belong, and neither taxpayer nor the Commissioner may transfer or permit the transfer of items of income or of deduction to a year in which they do not belong. Article 22 of Regulations 65.

In Paul and Mertens Law of Federal Income Taxation, Volume 1, Section 11.03, page 481, it is said:

> "The concept is fundamental that the law imposes the tax with reference to a fixed period of time. The income tax law is predicated upon annual periods; proving income for a period of years does not prove

income for any one year. The annual period is, of course, a matter of necessity if the law is to be administered; it has been called the cornerstone of our tax structure."

In *Newman* v. *Commissioner* (10th C. C. A.), 41 Fed. (2d) 743, the Court said:

"Income taxes are levied upon the basis of an annual accounting period. Rates are based upon the needs of the government for revenue and are continually changing. Annual accounting periods must be adhered to and arbitrary shifting of income from one year to another must be prevented in order to enable Congress to successfully adjust the rates to the needs of the Government. These have become fixed requirements in federal revenue taxation."

To the same effect are:

United States v. *Ludey*, 274 U. S. 295, 304.

Burnet v. *Sanford & Brooks Co.*, 282 U. S. 259.

Burnet v. *Thompson Oil & Gas Co.*, 283 U. S. 301.

Brown v. *Helvering*, 291 U. S. 193, 199.

Aluminum Casting Co. v. *Routzahn*, 282 U. S. 92.

Fawcus Machine Co. v. *United States*, 282 U. S. 375.

There is no need to multiply authorities on this for they are all one way.

In this case the evidence is undisputed that the taxpayer erroneously included on his return for 1924 the sum of $31,608.31 of an in-oil payment of $40,000 due to him from his lessee, and also the sum of $16,119.22 of oil

royalties, which he did not in fact receive until in 1925, and that the assessment of the tax involved in this action is based on the amended return made by deputy collector Sproles in which the above items are included in taxable income, notwithstanding they were not in fact income for 1924. The result of this erroneous transfer of items of income from the year in which they belong to another year is to distort income and subject the taxpayer to an erroneous tax liability in each year. Under all authority this may not be done except for some compelling reason which does not exist here.

The respondent pleads estoppel against the correction of error in the taxpayer's return for 1924 by which income belonging in 1925 was subjected to tax in 1924. It is elementary that one who relies on the defense of estoppel must plead and prove every essential element of it.

In *Van Antwerp* v. *United States* (9th C. C. A., 1937), 92 Fed. (2d) 871, the Court, after stating the rule, said:

> "These essential elements of estoppel, each of which the government must prove in this case, are set out in an authority cited in the government's brief:
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> " 'To constitute estoppel (1) there must be false representation or wrongful misleading silence. (2) The error must originate in a statement of fact and not in an opinion or a statement of law. (3) The person claiming the benefits of estoppel must be ignorant of the true facts, and (4) be adversely affected by the acts or statements of the person against whom an estoppel is claimed.' *U. S.* v. *Scott & Sons* (C. C. A. 1), 69 Fed. (2d) 728, 732."

The following, all of which are tax cases, support this proposition and the above-cited case:

Grand Central Public Market v. *United States* (D. C., S. D., Calif.), 22 Fed. Supp. 119.

Helvering v. *Brooklyn City R. Co.* (2d C. C. A., 1934), 72 Fed. (2d) 274.

Salvage v. *Commissioner* (2d C. C. A., 1935), 76 Fed. (2d) 112.

Commissioner v. *Union Pac. R. Co.*, (2d C. C. A., 1936), 86 Fed. (2d) 637.

Hull v. *Commissioner* (4th C. C. A., 1937), 87 Fed. (2d) 260.

Crossett Lbr. Co. v. *United States* (8th C. C. A., 1937), 87 Fed. (2d) 930.

Louis Werner Saw Mill Co. v. *Helvering* (Ct. App., D. C., 1938), 96 Fed. (2d) 539.

Helvering v. *Salvage* (1936), 297 U. S. 106.

McEachern v. *Rose* (1937), 302 U. S. 56.

Cases were presented by the respondent in the court below, and will doubtless be presented to this Court, dealing with situations where the taxpayer had erroneously taken a deduction in the wrong year and then sought to take it again in another year where it properly belonged after the bar of limitation had fallen on the correction of the error in the previous year. Some of these emphasize the fact that deductions from gross income are never a matter of right, but are allowed by Congress as a matter of grace and privilege and that a taxpayer, by claiming his

privilege at the wrong time, may lose his right to have it at the right time.

In the instant case we are not dealing with deductions, but with the erroneous taxation of income in a year in which it does not belong. All authorities recognize that a taxpayer has the fundamental right and is under the imperative duty to see that his income for each period is correctly determined. Otherwise his income will be distorted and be either too high or too low in any year in which it is not correctly determined, and if items of income may be transferred from one year to another, they may be subjected to tax in a different rate bracket or under a different statute and on a different basis in the year to which they are transferred from the year in which they are properly taxable.

In this case the trial court did not find that the Commissioner or the collector was without means of ascertaining knowledge of the facts in respect of the taxpayer's return for 1924, nor that they were actually without such knowledge.

The uncontradicted evidence shows that respondent's deputy collector Sproles, and the revenue agent Hardcastle, both had knowledge of the facts within the period of limitation on the assessment of tax for 1925 (R. 111, 117). Sproles testified that he did not have recollection of Carey's statement to him in April, 1925 (142), but his testimony that he did not recollect that statement is not a denial that it was made. There was no denial of Carey's testimony that in 1928 he called revenue agent Hardcastle's

attention to the fact of the erroneous inclusion of 1925 income on the 1924 return. Again Sproles testified that he had a conversation with Carey in April, 1925, with respect to the taxpayer's 1924 return and said:

> "We had already made an examination of the Hughes County records and had information in regard to these leases and royalty items" (R. 144).

Certainly the Commissioner had the means of acquiring full knowledge in respect of every item in that return, and his deputy collector who actually made the amended return says that he had made an examination and had information in regard to those items when he prepared that return.

The authorities cited are convincing that under the facts of this case the taxpayer is not estopped to claim in this action a refund of tax based on the erroneous inclusion in 1924 income of items which belonged in another year. The fact that such items are included in income and subjected to tax in 1924 is not disputed in the evidence and is specifically found by the Court (R. 50).

We quote briefly from two of the cases last cited.

In *Hull* v. *Commissioner, supra,* an income tax case, the Court said:

> "The contention that the petitioner not having returned the payment as taxable income for the year 1925, is estopped from contending that the payment was taxable, if at all, in that year, is not a sound one.
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> * * * * * * *
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> "Estoppel is an affirmative defense, and the burden is upon the party asserting it to establish both the facts

necessary to support it and the fairness of its application, and a party either knowing the facts, or in a position to know them, cannot claim the benefit of estoppel. *Helvering* v. *Brooklyn City R. Co.* (C. C. A), 72 Fed. (2d) 274; Jones on Evidence (3rd Ed.), Para. 279."

In *McEachern* v. *Rose, supra,* the Court said:

"But Congress has set limits to the extent to which courts might otherwise go in curtailing a recovery of overpayments of taxes because of the taxpayer's failure to pay other taxes which might have been but were not assessed against him."

In the Court's opinion (R. 50) reference is made to the Form O which Carey prepared in 1928 and it is said that the 1925 items were reported therein as income for 1924 and a deduction for depletion claimed upon them. An examination of this exhibit in the record fails to sustain the Court's statement (215-217). It does not appear upon what income the depletion claimed by this Form O was based. And in any event in preparing it Carey was merely complying with the requirements of the Treasury Regulations in respect of the revaluation of property for discovery depletion and would of necessity use the income from the property as shown on the taxpayer's amended return prepared by deputy collector Sproles and likewise would of necessity use the only method of determining discovery value on the taxpayer's property which the Commissioner recognized and would permit. Only by complying with those requirements could the taxpayer receive such depletion deduction as the Commissioner was willing to allow.

His claim for a different determination of the income subject to depletion and a different discovery value on his property could be raised only by contesting the Commissioner's determination of a deficiency, first, by an appeal to the Board, which he did, and then, after that terminated without an adjudication on the merits, but by dismissal for lack of jurisdiction, and after he had been entrapped into the asserted payment of part of the alleged deficiency in tax, by filing his claim for refund and bringing this action to recover. It does not appear that there was anything in the Form O that could operate as an estoppel against the taxpayer, for it simply was his effort to obtain such deductions from the income reported on the deputy collector's amended return as the Commissioner would permit to him on the facts of that return and under the Commissioner's rules for determining discovery value.

Plainly on the undisputed facts the respondent has failed to sustain his burden of proving the essential elements of an estoppel. The fact, the nature and the extent of the error in the taxpayer's return for 1924, resulting in the imposition of tax upon purported income to him in that year which was actually received in and belonged in another year, is not disputed and is admitted. The only reason given by the Commissioner and by the courts below for denying the taxpayer a refund of such admittedly erroneously overpaid tax is that it is now too late to tax the items erroneously taxed in 1924 in the year in which they belong and in which they should properly be taxed. Under all the authorities this is not a sufficient ground for

refusing the correction of the admitted error in respect of the year 1924.

The cases cited by the court below to sustain its position are all distinguishable on the facts from this case.

Proposition Two.

The taxpayer was entitled to have his allowance for depletion on the oil production and bonuses for leases received from his land in 1924 computed on the discovery value thereof resulting from the Hully Sands offset well, part of the cost of which he paid for the purpose of discovering oil on his land and by which he did discover oil on it.

Section 214(a) (9) of the Revenue Act of 1924 provides that in computing net income there shall be allowed as a deduction in the case of oil and gas wells a reasonable allowance for depletion to be made in all cases under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary.

The pertinent part of Section 204(c) of this Act is as follows:

> "The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that *in the case of* mines, *oil and gas wells, discovered by the taxpayer,* after February 28, 1913, and not acquired as the result of purchase of a proven tract or lease, where the fair market value of the property is materially disproportionate to the cost, *the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter.*"

Articles 201 to 228, inclusive, of Regulations 65 deal with the determination of depletion deductions on mines and oil and gas wells. The pertinent part of these Regulations here is Article 222 which is in part as follows:

"*Discovery—Proven Tract or Lease—Value Disproportionate to Cost.*—(1) For the purpose of section 204(c) of the Revenue Act of 1924, an oil or gas well may be said to be discovered when there is either a natural exposure of oil and gas, or a drilling that discloses the actual and physical presence of oil or gas in quantities sufficient to justify commercial exploitation.

* * * * * * *

"A proven tract or lease may be a part or the whole of a proven area. A proven area for the purposes of this statute shall be presumed to be that portion of the productive sand or zone or reservoir included in a square surface area of 160 acres having as its center the mouth of a well producing oil and/or gas in commercial quantities. In other words, *a producing well shall be presumed to prove that portion of a given sand, zone, or reservoir which is included in an area of 160 acres of land, regardless of private boundaries.* The center of such square area shall be the mouth of the well, and its sides shall be parallel to the section lines established by the United States system of public-land surveys in the district in which it is located. Where a district is not covered by the United States land surveys the sides of said area shall run north and south, east and west.

"So much of a taxpayer's tract or lease as lies within an area *proven either by himself or by another* is 'a proven tract or lease' as contemplated by the statute, and the discovery of a well thereon will not entitle such taxpayer to revalue such well for the purpose of

depletion allowances, *unless the tract or lease had been acquired before it became proven.*"

The fact situation to which the cited statute and Regulations are sought to be applied may be briefly restated here. At the beginning of the year certain land of the taxpayer was unproven for oil and gas. For the purpose of testing and proving this land he contributed an offset oil and gas lease to the cost of the Hully Sands well, without which contribution it would not have been drilled. That well came in a producer on August 16, 1924, and proved his adjoining land valuable for oil and immediately rendered its oil value disproportionate to its cost, for he had no cost in its mineral value. He claims the fair market value of it at any time within thirty days after that well was brought in as discovery value to be taken as the cost basis for the determination of his depletion allowance. The Commissioner contends that under the statute and the Regulations a taxpayer cannot claim discovery value unless he drills a producing well on his own land, even though he helps pay for an offset well which proves his land for oil, and that he is excluded from ever having any discovery value on his land thus proven, even though he later actually brings in a well on it.

It will be noted that under the statute discovery value is allowed in the case of an oil well "discovered by the taxpayer" and not acquired as the result of purchase of a proven tract or lease. *The statute does not say that a taxpayer must have a well on his own land to discover oil thereon. Neither do the Regulations so say.* Nor is there any rea-

son apparent why a taxpayer, who in good faith for the purpose of discovering oil on his land expends his money or money's worth in the drilling of a well on another's land, but in such close proximity to his that if productive it will have the effect to discover oil on his land, should be denied the benefit of discovery value for his land based on such well. Without dispute he comes within the spirit of the statute and Regulations, for certainly he has, by his own effort and his own expenditure of money or money's worth for that very purpose, discovered oil on his land.

The drilling of oil wells is expensive and it is so common as to be the rule, rather than an exception, that the drilling of a well in an unproven area, that is, a wildcat well, is made the subject of joint expenditure and risk of the owners of lands and leases surrounding it which will be tested by it and proven productive if it is a producer. It is contrary to sound reasoning to say that only the owner of the land or leasehold on which the well is drilled can claim discovery value by reason of such well when others have helped to pay the cost of it for the purpose of discovering oil on their lands and leases, and through it have accomplished that purpose. Certainly one can discover oil on his land without actual production of oil from it.

The Regulations provide that a producing well is *presumed* to prove, that is, to *discover* oil upon, "a square surface area of 160 acres having as its center the mouth of a well." This being a *presumption* only, it may be overcome by evidence in any case and is so overcome here. It requires no argument to establish that such presumption is purely

arbitrary and without foundation in fact or reason. Everyone knows that oil deposits have no respect for section and quarter-section lines which mere man lays out on the surface for his convenience in describing property. There has never yet been a discovery well which in fact proved an area of 160 acres in a square form with a well in the center and no more and no less. In truth a discovery well proves an area not subject to arbitrary determination, but indefinite both in extent and in shape and variable with each well. Certainly it *discovers* oil on land to which it is an offset, according to both the dictionary and the common-usage definition of that term.

Engineer Revenue Agent Dyche, testifying for the respondent, said that it was a fact that a well would generally prove a much larger area than 160 acres, the extent and trend of it being dependent upon the geology of the area, and that, from his knowledge of the field where in 1924 the Hully Sands well came in offsetting the Ryan land, that well would prove at least the north half of Section Two, and with less certainty the involved 40 acres adjoining this tract on the south, and that in the production and operation of the Hully Sands well over a period of time it would drain oil from the Ryan land (R. 135-138).

So it is not only a matter of common knowledge, but is proven by the testimony of a competent witness, a skilled petroleum engineer long in the service of the Government (R. 128-129), that the Hully Sands well did in fact prove valuable for oil the land of the taxpayer here involved, which means that it did in fact to the ordinary understand-

ing *discover* oil on his land. Dyche's testimony as a petroleum engineer, and with at least some knowledge and experience as a petroleum geologist, is corroborated in this case by the practical views and opinions of hard-headed oil operators who paid $1,000 an acre bonus for an oil and gas lease on 80 acres of this land within two days after the Hully Sands well came in and $1,250 an acre bonus for an oil and gas lease on another 80 acres of it in 33 days after the Hully Sands well came in, and by qualified witnesses who testified without contradiction or dispute that, within 30 days after that well came in, this land had a lease bonus value of $1,250 an acre, and a royalty value of the same amount (R. 84, 88).

The Regulation quoted says that the property upon which discovery value must be established is the *well*, but defines the well as all of the proven area "to the limit of the taxpayer's private bounding lines," but not exceeding the 160 acres in a square form. This Regulation is the closest approach to a declaration that a taxpayer may not have discovery value on his property unless the well is drilled on his own land. Yet it does not expressly say so and there is no reason, and no support in the statute, for limiting the *method* by which a taxpayer may *discover* oil on his land to the drilling of a well thereon by him. The statute says that where the taxpayer's property is proven productive by oil *discovered* by the taxpayer, which means *discovered* in any manner which definitely determines that it is productive, and its value is thereby rendered disproportionate to its cost, he is entitled to have his depletion allowance computed on discovery value in lieu of cost.

The only decided case on a question similar to the one here presented is *Security First National Bank of Los Angeles* v. *Welch* (1937, C. C. A. 9th), 92 Fed. (2d) 357. The facts there were that the discovery well in the Torrance oil field was brought in in 1921. The leases on which depletion based on discovery value was claimed were sold on June 30, 1924, some three years later. The majority opinion of the Court holds that the taxpayer could not have the benefit of discovery value on his property, because it was proven productive by the discovery of oil on the land of another, even though this was immediately adjoining his. It is not clear from the fact statement whether there was a producing well offsetting the taxpayer's land. There is a very vigorous dissenting opinion in that case which states the argument of the petitioner here. But there is a vital fact distinction between that case and this one. *Here the taxpayer participated in and shared the cost of the drilling of the offset well which proved his property.* This fact ought to tilt the balance on which the above case was decided in favor of the taxpayer here.

Certainly there is no express provision in the law or regulations which requires the taxpayer to drill at his own expense a well on his own land to have the benefit of discovery value, and in sound reasoning and fundamental justice there is no reason for the adoption of an arbitrary rule which would deny him the benefit of discovery value on his land when he participates in the drilling of a well adjoining it for the purpose of discovering, and which does in fact discover, oil on his land. We respectfully ask this

Court to examine with care both the majority and the minority opinions in the cited case and then, upon consideration of the statute, the regulations and those opinions, and this Court's own views as to what should be the reasonable, fair and just interpretation of the statute, decide this question.

The Appeals Court says that a taxpayer is not entitled to a depletion allowance as a matter of right, and that provision for it is an act of grace. Authorities are cited which so hold (R. 226). With this we fully agree, but where, as here, Congress has seen fit as an act of grace to grant a depletion allowance under certain conditions, *any taxpayer who comes within those conditions is entitled to that allowance as a matter of right.* In this case the taxpayer is not seeking some privilege or benefit outside of and beyond the statute, but is contending for the claimed depletion allowance *on the ground of compliance with the very terms and conditions of the statute which grants it.*

The Commissioner has always recognized and allowed discovery value to the fee owner of land where his lessee drilled a discovery well thereon at the lessee's sole expense. This is regarded as discovery by the fee owner, although he contributed nothing to the cost of the well and had no control over the drilling of it, and if it is a producer and renders the value of his royalty right in the fee disproportionate to its cost, he may take that value in lieu of cost for the purpose of computing his depletion allowances. There is no distinction in principle between a fact situation in which a landowner gives an oil and gas lease on his land

to a lessee who at his own cost drills a well thereon in which oil is discovered, and the one in which the landowner contributes a substantial amount in value to the drilling of a well on another's land which offsets his, for in both situations the landowner, in fact and in law, discovers oil on his land and makes its value disproportionate to its cost.

Let us assume that a taxpayer owns a tract of land and also an undivided interest with one or several others in an adjoining tract and that these joint owners drill a well for oil on the tract they own offsetting the tract which he owns exclusively. If such well is a producer, it proves not only the land on which located, but under the Regulations also the adjoining land insofar as it is included in 160 acres in a square form with the well in the center. Not even the Commissioner would contend in such case that the taxpayer had not discovered oil and was not entitled to discovery value on the tract on which the well was situated to the extent of his interest therein and equally on the land which he owned exclusively within the admittedly proven area. So here if Ryan had owned an undivided interest in the fee or the leasehold on which the Hully Sands well was situated, and then, as he did, had contributed a lease on an offsetting 40 acres of his land as his share of the cost of that well, then not even the Commissioner would dispute that he had discovered oil on that part of the land he owned exclusively which was within the area proven by the Hully Sands well according to the Regulations, nor dispute that he was entitled to discovery value on his interest in each property.

The unqualified statutory right of the taxpayer to the deduction of an allowance for depletion on a bonus received for an oil and gas lease in advance of any production on the property covered by such lease is settled by the decision of this Court in *Herring* v. *Commissioner* (1934), 293 U. S. 322. Such bonus is an advance royalty. This right is equally well established regardless of whether the depletion is based on cost or discovery value or is percentage depletion. The foregoing case is supported by the following which are cited therein:

Burnet v. *Harmel*, 287 U. S. 103.

Murphy Oil Co. v. *Burnet*, 287 U. S. 299.

Bankers Coal Co. v. *Burnet*, 287 U. S. 308.

Palmer v. *Bender*, 287 U. S. 551.

The rule applies whether the sale of the lease is followed by production from the property within the taxable year or not. In this case there was production from each property leased within the taxable year (R. 217). *But the taxpayer has not been allowed a cent of depletion on the bonuses he received for those leases. Herring* v. *Commissioner, supra,* has been cited and followed many times, but it has never been modified or criticized and is controlling here and hence there is no need to present further authorities to the same effect.

The following Treasury decision and rulings of the Bureau also support the taxpayer's contention here:

T. D. 3938, C. B. V-2 117; G. C. M. 11384, C. B. XIII-1 64; I. T. 2361, C. B. VI-1 73.

The fact issue as to the amount of taxpayer's depletion allowance based on discovery value resulting from the Hully Sands well can be determined on the record as made when and if the legal question of his right to such depletion allowance is determined in his favor. Then the amount of the allowance will become a matter of re-computation.

It may be observed that the statute authorizing depletion on discovery value of an oil property passed out with the Revenue Act of 1926 which provided for percentage depletion or cost depletion without the benefit of discovery value, whichever was greater, and so the Regulations involved here do not have the sanction of the re-enactment of the same statute in the light of their provisions. Nor does it appear that there has been any settled interpretation of them as the respondent interprets them here which has met congressional approval, nor will the interpretation of them as contended for by the petitioner here disrupt or disturb the settled administration of the revenue laws by the Bureau. There is no such thing as depletion on discovery value since 1925.

Proposition Three.

The assessment and collection in 1925 of a deficiency in the taxpayer's tax for 1924 was illegal and void in its entirety because made while his appeal from the determination of such deficiency was pending before the Board of Tax Appeals, or, if his appeal to the Board was void, then because made after the assessment and collection of such deficiency was barred by limitation.

Section 274(a) of the 1926 Act provides that when the Commissioner determines a deficiency in tax he shall send a notice to the taxpayer by registered mail and the taxpayer may file a petition with the Board of Tax Appeals for redetermination of the deficiency within 60 days after the mailing of the notice, and then provides further:

> "No assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60-day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final."

Section 274(a) of the 1924 Act is substantially the same as the foregoing, and Section 272(a) of the 1928 Act is identical with it.

Section 277(b) of the 1924 Act suspended the running of the statute of limitations for 60 days after the notice of deficiency was given, and, if an appeal was filed with the Board, then until the decision of the Board had become final.

Section 277(b) of the 1926 Act provided that the

statute of limitations was suspended for the period during which the Commissioner *was prohibited from making the assessment or beginning distraint* or a proceeding in court and for 60 days thereafter.

Section 504(a) of the 1928 Act provided that the running of the statute of limitations was suspended:

> "For the period during which the Commissioner is prohibited from making the assessment or beginning distraint or a proceeding in court *(and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Board, until the decision of the Board becomes final)*, and for 60 days thereafter."

Then Section 504(b) of the same Act provided that:

> "Subsection (a) of this section shall apply in all cases where the period of limitation has not expired prior to the enactment of this Act."

Section 277(a)(2) of the 1926 Act provided a limitation on the assessment of any income taxes imposed by the 1924 Act of "four years after the return was filed." This is the same limitation prescribed in Section 277(a)(1) of the 1924 Act.

The record in this case shows that plaintiff's return for 1924 was filed on March 16, 1925, March 15 being Sunday. Therefore the time within which any additional tax could be assessed against the taxpayer expired on March 16, 1929. If the taxpayer had not filed his petition and docketed the case on appeal with the Board, the assessment made by the Commissioner in November, 1929, would have been about seven months too late and would have been a void assessment because barred by limitation.

Under the provisions of the statute cited the filing of the taxpayer's petition with the Board and the docketing of a proceeding in respect of the deficiency involved, had the effect to prohibit the Commissioner from assessing the deficiency or begining distraint, and to suspend the running of the statute of limitations, while that proceeding was pending. Obviously if that proceeding did not have such effect, then under Section 504(a) of the 1928 Act it did not have the effect to suspend the running of the statute of limitations, for the suspension of the running of the statute is expressly conditioned:

> "for the period during which the Commissioner is prohibited from making the assessment or beginning distraint."

The fact that the Board ultimately determined that it had no jurisdiction, because the petition and proceeding before it was not timely filed and docketed, is of no consequence with respect to the effect of that proceeding while it was pending. Whether the proceeding was or was not timely filed and docketed and whether the Board did or did not have jurisdiction was necessarily undetermined until finally adjudicated by the Board. And the pendency of the proceeding before the Board until that time had all the effect, with respect to prohibiting the Commissioner from making an assessment or beginning distraint and to the suspension of the running of the statute of limitations, that a proceeding regular and valid in all respects would have had. This seems to be definitely established by the following cases with none to the contrary:

American Equitable Assurance Co. v. *Helvering* (C. C. A. 2d), 68 Fed. (2d) 56.

USL Battery Corporation, 32 B. T. A. 810, 812.

Puget Sound National Bank, 36 B. T. A. 386, 390.

Marie Minor Sanborn, 39 B. T. A. 721, 725.

In *USL Battery Corporation* v. *Commissioner* (2d C. C. A.), 84 Fed. (2d) 1020, certiorari denied 299 U. S. 593, the Board decision in *USL Battery Corporation, supra*, is affirmed in the following language:

> "Affirmed on authority of *American Equitable Assur. Co of New York* v. *Helvering*, 68 Fed. (2d) 144 (C. C. A. 2d)."

The court below in support of its holding on this point cites *Lewis-Hall Iron Works* v. *Blair*, 57 App. D. C. 364, 23 Fed. (2d) 972, 974; *Chambers* v. *Lucas*, 59 App. D. C. 327, 41 Fed. (2d) 299; and *Continental Petroleum Co.* v. *United States* (10th C. C. A.), 87 Fed. (2d) 91, 94. An examination of these cases shows that they do not in any respect touch the point here made by petitioner, but deal with the definition of what constitutes a *petition* before the Board and of what constitutes a *filing* before the Board. Section 504 of the 1928 Act is not considered at all in those cases nor by the court below in this case.

The assessment of tax by the Commissioner during the time prohibited by statute for making an assessment or beginning distraint is void and tax paid or collected on such assessment may be recovered for the taxpayer. The following authorities support this statement and the holding of the court below to the contrary is in direct conflict with them:

American Equitable Assur. Co. v. *Helvering, supra.*

Ventura Consolidated Oil Fields v. *Rogan* (1936, C. C. A. 9th), 86 Fed. (2d) 149, ceritorari denied 300 U. S. 672.

United States v. *Yellow Cab Co.* (C. C. A. 7th), 90 Fed. (2d) 699.

United States v. *Barber* (D. C. N. D.), 24 Fed. Supp. 229.

United States v. *Barber* (D. C. N. D.), 25 Fed. Supp. 197.

Bowers v. *New York & Albany Lighterage Co.*, 273 U. S. 346.

United States v. *Continental National Bank & Trust Co.*, 305 U. S. 398.

If the holding of the court below is right, then the foregoing cases are wrong, and if they are right, the holding of the court below is wrong, and as well the cases of *Van Antwerp* v. *United States* (9th C. C. A.), 92 Fed. (2d) 871, and *Lehigh Portland Cement Co.* v. *United States* (Ct. Cl.), 30 Fed. Supp. 217, 224, 233, which are cited by that Court.

If for no other reason than to resolve the conflict in those decisions, this Court should grant the petition for certiorari in this case.

And if the deficiency in tax here involved was assessed after the expiration of the period of limitation on the assessment thereof, then the amount paid on such assessment is by statute specifically made recoverable by the taxpayer. Section 607 of the Revenue Act of 1928 provides as follows:

> "Any tax (or interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the ex-

piration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim."

This statutory rule is recognized and applied in *Welch* v. *Schweitzer* (9th C. C. A.), 106 Fed. (2d) 885, and *McEachern* v. *Rose*, 302 U. S. 56.

If the assessment of tax by the Commissioner during the period in which he is expressly prohibited by statute from making it, is deemed merely irregular and premature, then the statute is repealed. But until this Court so holds, the taxpayer is entitled to the benefit of the statute as it stands.

Proposition Four.

If by depositing $36,500 with the collector to be held in a special fund without assessment the taxpayer waived the statutory restrictions on assessment of that sum while his appeal was pending before the Board of Tax Appeals, still the assessment of the additional sum of $9,135.73 and the collection thereof by distraint was an illegal and void assessment and collection, because made while his appeal was pending before the Board, or, in event that appeal was a nullity, then because made after the assessment and collection thereof was barred by limitation.

This proposition is in part a corollary to the preceding one. But the courts below held that the deposit of $36,500 made on October 2, 1929, by the taxpayer with the collector in reliance on the collector's express agreement that it would be held in his unidentified fund account without

application on any tax liability and without assessment of any tax until the pending case before the Board became final, constituted a waiver on the taxpayer's part of the restrictions on the Commissioner's power to assess the tax. In this those courts assume that said sum was paid to the defendant to be applied on a tax liability instead of, as it was in fact, being deposited to be held in a specified account without application on tax liability. It was contended by respondent below that as collector he had no authority to receive a deposit such as this and carry it in an unidentified fund account. Assuming, without admitting, that this is true, still the Commissioner was without right to assess a tax and appropriate this deposit in payment of a part of that tax. The collector was the Commissioner's agent and representative, not only in collecting taxes, but in receiving deposits such as that made by the taxpayer here, *or else was acting in an individual and unofficial capacity, and so would be personally liable for appropriating the fund to an unauthorized purpose.*

It is elementary law that if one deposits a sum of money with another upon particular and agreed conditions, the one receiving it may not divert and appropriate it to some purpose contrary to that for which it was received. If an agent, in excess of his authority, receives a sum upon certain stipulated conditions, his principal may not in violation of those conditions, appropriate the money to some other purpose. If the act of the agent in receiving the money is repudiated as unauthorized, the only course open to the principal is to direct the agent to return the money. And if the respondent in receiving the taxpayer's money

on deposit was acting unofficially, then the Commissioner clearly had no legal right to assess the tax and the respondent had no right to apply the deposit in payment of it. This action is against the respondent, not against the United States.

The rule is analogous to that in respect of a tender of payment which requires that a tender, if accepted at all, must be accepted as made, for the acceptor cannot take the money and graft new terms and conditions on the tender, nor apply the money for some other purpose than strictly that for which it was paid.

In *Ventura Consolidated Oil Fields* v. *Rogan* (1936, C. C. A. 9th), 86 Fed. (2d) 149, certiorari denied, 300 U. S. 672, the Commissioner tried to hold the taxpayer bound by a proposed compromise and waiver of appeal which the Commissioner had not accepted. In ruling against the Commissioner, the Court said:

> "The Commissioner may not take that portion of the proposed compromise which suits him and reject the rest. *La Compania Bilbaina De Navegacion De Bilbao* v. *Spanish-American Co.*, 146 U. S. 483, 496, 13 S. Ct., 143, 36 L. ed. 1054. If a taxpayer's waiver of restrictions is given upon a condition, the Commissioner may not take advantage of the waiver without complying with the condition. *William C. Atwater & Co.* v. *Bowers* (C. C. A.), 74 Fed. (2d) 253, 256."

But if the depositing of $36,500 was a waiver of restriction on the assessment of that amount, it could not be deemed a waiver on the assessment of the additional sum of $9,135.73 which the Commissioner made at the same

time, nor for the collection of such sum by the respondent under distraint warrant while the taxpayer's appeal was pending before the Board. In fact the Commissioner's letter to Carey under date of December, 1929, indicates that the collector's action in enforcing payment of that $9,135.73 by distraint was unauthorized, for he says:

> "Since you indicate that the Collector is endeavoring to collect the full amount of the assessment in the amount of $45,635.73, the matter is being taken up with that official" (R. 113).

Since by no possibility could the taxpayer be deemed to have waived restrictions on assessment of this $9,153.73, the assessment and the collection of that sum by distraint by the respondent was done at a time when such assessment and collection was expressly prohibited by statute, because taxpayer's appeal to the board was a proceeding docketed and pending therein in respect of such deficiency, or if the taxpayer had no appeal and proceeding docketed and pending before the board, then the assessment and collection of said sum was barred by limitation. This is established by the authorities cited under the preceding proposition, which need not be repeated here.

CONCLUSION

In conclusion the petitioner says that the decision of the Circuit Courts of Appeals in this case is in direct conflict with the decisions of other Circuit Courts of Appeals on the same matter and also with the decisions of this Court, and is in direct conflict with various applicable statutory provisions which are not referred to in its decision, and is funda-

mentally wrong in its effect of denying to petitioner a depletion allowance on his oil properties, his right to which comes within the letter and the clear import of the statute. And if it should be deemed that the amount paid by taxpayer and involved herein is no more than his just tax liability, still he has been denied the benefit of the statutory provisions which control, restrict and limit the manner, power and time for the assessment and collection of such tax by the Commissioner. Those statutory provisions may be classified as technical grounds for the relief claimed, but since Congress has enacted such provisions, all the courts, including this Court, should observe them. They are intended for orderly procedure in collecting taxes and every taxpayer is entitled to the full benefit of them for his protection. If they are to be repealed, they should be repealed by Congress and not by the courts, either by direct rejection or disregard of them or by construing them out of existence. While they stand the taxpayer has a right to be taxed according to the forms of law.

The petitioner asks that this Court grant the writ of certiorari as prayed for and review the decision of the court below.

Respectfully submitted,

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